COMPARISON OF

PRESENT LAW AND RECOMMENDATIONS

OF THE SUBCOMMITTEE ON OVERSIGHT OF THE

COMMITTEE ON WAYS AND MEANS

Relating to the tax treatment of private foundations

Prepared by the staff of
The Joint Committee on Taxation

for the use of

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INTRODUCTION

This document, prepared for the use of the Committee on Ways and Means, provides a comparative description of present law and the recommendations of the Subcommittee on Oversight of the Committee on Ways and Means relating to the tax treatment of private foundations, as set forth in the Subcommittee press release dated September 16, 1983.

Item	Present Law	Subcommittee Recommendations
I. Charitable Deduction Rules (IRC sec. 170)		
a. Carryovers of Contributions Exceeding Percentage Limitations	Contributions to public charities and operating foundations in excess of the percentage limitations (below) may be carried forward and deducted over the next five years. Excess contributions to nonoperating (grantmaking) foundations may not be carried over.	Allow a five-year carryover of excess contributions to all private foundations.
b. Percentage Limitations	Contributions by individuals to public charities and operating foundations are deductible up to 30 percent of the donor's adjusted gross income in the case of capital-gain property (such as appreciated stock), and 50 percent in the case of cash or contributions of ordinary-income property. Contributions of property or cash to nonoperating foundations are deductible up to 20 percent of the donor's adjusted gross income.	Retain present law.
c. Appreciated Capital-Gain Property	Deductions for contributions to public charities and operating foundations generally are allowed for the fair market value of contributed capital-gain property. Deductions for contributions to nonoperating foundations are allowed for the taxpayer's basis in the property plus 60 percent of the appreciation (i.e., 60 percent of the difference between value and basis).	Retain present law.

Item	Present Law	Subcommittee Recommendations
II. Definition of Public Charities--10-Percent Support Test (secs. 509(a)(1), 170(b)(1)(A)(vi))	Private foundations are subject to a 2-percent excise tax on net investment income and a series of rules violations of which trigger other excise taxes. The definition of private foundations excludes certain organizations that receive at least 10 percent of their support from the general public. Organizations that provide services directly to the public (e.g., museums, libraries, or orphanages), that have substantial public representation on their governing bodies, and that may have been publicly supported in the past, nonetheless may be classified as private foundations, and hence become subject to the tax on investment income, if their endowment assets and investment income increase significantly.	Provide an exemption from the 2-percent tax on net investment income for existing organizations which exhibit certain characteristics indicating substantial public involvement (such as museums, libraries, and orphanages) if the organization's governing body meets specific standards of public representation. Possible implementation: Provide an exemption from the 2-percent tax for such operating foundations that have been publicly supported, if the organization's governing body is broadly representative of the general public (with at least 75 percent consisting of persons otherwise unrelated to the foundation), and if none of the foundation's officers are disqualified persons. Effective date: Generally, post-1983 taxable years.
III. Excise Tax on Net Investment Income (sec. 4940)	Private foundations are subject to a 2-percent excise tax on net investment income. The amount of the tax reduces the amount which the foundation must disburse for charitable purposes under section 4942.	Reduce the tax on net investment income to 1 percent, provided that the foundation's current payout for charitable purposes is increased by an equivalent amount (i.e., a foundation may not reduce its current payout and take advantage of this provision).

Item	Present Law	Subcommittee Recommendations
IV. Mandatory Payout Rules (sec. 4942)	Nonoperating (grantmaking) foundations generally must distribute or spend annually for charitable purposes amounts equal to 5 percent of the value of their net investment assets. Administrative expenses incurred in carrying out the foundation's charitable activities may be counted in determining whether the 5-percent distribution is met, and thus may reduce the actual amounts which are distributed to charitable beneficiaries.	Limit the amount of administrative expenses which may be counted toward satisfying the payout requirement. Possible implemention: Set limit at 15 percent of the amount of grants or contributions made by the foundation for the year.
V. Expenditure Responsibility Rules (sec. 4945)	Foundations must exercise "expenditure responsibility" over grants to other foundations. The grantor must establish adequate procedures, and make reasonable efforts, to see that the grant is used for charitable purposes (and not, e.g., for prohibited lobbying), obtain a report from the grant recipient, and report on the grant to the IRS. Specific guidelines are set forth in Treasury regulations.	The Treasury Department is to review its expenditure responsibility regulations for purposes of modifying requirements which are found to be unduly burdensome or unnecessary. Treasury is to report to the Committee on its review and modifications. Possible implementation: As part of its review, Treasury is to modify the required grantor reports to the IRS and the penalties applicable for failure to comply with these requirements.

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VI. Reliance on IRS Determination of Grantee Status (sec. 4945)	Treasury regulations and IRS guidelines specify when a grantor foundation may rely on IRS classification of an organization as a public charity, so that the grantor need not exercise expenditure responsibility over its grant to the organization.	The Treasury Department is to modify its regulations to extend the two-year advance ruling period during which qualifying new organizations are considered public charities. Also, Treasury is to review its guidelines concerning the circumstances under which a donor foundation will not be considered responsible for a "substantial and material" change in support of the donee organization, to determine whether further reliance on published IRS classifications can be facilitated in the case of newly formed organizations. Treasury is to report to the Committee on its efforts regarding this matter.
VII. Voter Registration (sec. 4945)	Expenditures by foundations for political purposes trigger excise taxes. However, under strict limitations, a foundation may support voter registration drives if the organization making the registration drive is a tax-exempt section 501(c)(3) organization which expends substantially all of its income for exempt purposes and generally is publicly supported, and if the registration drive activities are nonpartisan, are not confined to one specific election period, and are carried on in five or more States.	All requirements of present law would be retained except the requirement that the voter registration drive must be conducted in five or more States. Thus, the drive could be conducted within one State provided it is nonpartisan, is not confined to one election period, and meets the other requirements of present law.

Item	Present Law	Subcommittee Recommendations
VIII. Definition of Disqualified Person (sec. 4946)	For purposes of several foundation provisions, "disqualified persons" include substantial contributors and foundation managers, and members of their families. Family members are defined as the spouse, ancestors, and lineal descendants (and their spouses) of the substantial contributor or foundation manager.	Descendants more distant than great-grandchildren would be excluded from the definition of family member. Thus, members of the family would include the spouse of the substantial contributor or foundation manager, ancestors, and the children, grandchildren, and great-grandchildren (and spouses of such children, etc.) of the substantial contributor or manager.
IX. First-Tier Penalty Taxes (secs. 4941-45)	The private foundation rules are enforced by a two-tier system of regulatory excise taxes. The first-tier tax on the foundation (or in the case of self-dealing, on the self-dealer) applies automatically when a foundation rule is violated.	The IRS would be given discretionary authority to abate the first-tier penalty taxes (other than the tax on the self-dealer) if the foundation establishes that the violation was due to reasonable cause and not to willful disregard of the law.
X. Public Disclosure and Accessibility of Information on Foundations to Grant Applicants (sec. 6104)	Private foundations are required to file detailed information returns with the IRS; these returns are available to the public. Also, the foundation must publish a newspaper notice that its IRS return is available at its principal office.	The IRS is to enforce fully the present-law rules concerning the filing of complete annual returns, including assessment of penalties (in appropriate cases) for failure to file a complete return. Also, the required newspaper notice must contain telephone numbers.

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XI. Excess Business Holdings (sec. 4943)	a. Post-1969 gifts or bequests Private foundations are precluded from acquiring significant holdings (called "excess business holdings") in any one company. If a private foundation acquires excess business holdings by gift or bequest after 1969, it has 5 years to dispose of those excess holdings.	With respect to holdings acquired after 1969 by gift or bequest, the IRS would be given discretionary authority to permit additional time for divestiture of such excess business holdings on a showing by the foundation of good cause plus good faith efforts to dispose of excess holdings within the normal 5-year period.

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	b. Grandfathered holdings In the case of excess business holdings held by foundations in 1969, excess business holdings must be disposed of in two phases under the following timetable: Phase One If holdings of foundation exceeded 95% in 1969, 20 years to reduce to 50% (1989 deadline). If holdings of foundation and disqualified persons were greater than 75% in 1969, 15 years to reduce to 50% (1984). If holdings of foundation and disqualified persons were greater than 50% but less than 75% in 1969, 10 years to reduce to 50% (1979).	Phase One divestiture rules Option (1): Retention of current law. Option (2): Exemption from the divestiture rules of section 4943 for holdings of private foundations acquired prior to May 26, 1969, if: (i) less than a majority of the governing body of the foundation (Board of Directors or trustees) consists of officers and/or employees of the business enterprise classified as an "excess business holding," and (ii) the foundation meets the minimum payout requirements of existing law. In addition, nonvoting preferred stock would not be counted in determining whether there is an excess business holding by a private foundation. Option (3): Exemption from the divestiture rules of section 4943 for holdings of private foundations acquired prior to May 26, 1969, if: (i) the business enterprise and the private foundation do not have interlocking or related governing bodies, officers, and/or employees; (ii) the annual minimum cash return on the excess business holdings equals 7.5 percent; (iii) the foundation's annual payout equals 7.5 percent of the minimum investment return, and (iv) there is no increase in the excess business holdings.

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	Phase Two Combined holdings of foundation and disqualified persons must be reduced, in certain cases, to 35% within 15 years after end of Phase One. In addition, the foundation itself may not hold more than 25% of the voting stock, dependent on whether disqualified persons own more than 2%.	Phase Two divestiture rules Simplify Phase Two divestiture rules.
	c. "Downward-ratchet" rule If the foundation's holdings during Phase One or Phase Two decrease below otherwise permitted amounts, then foundation holdings cannot later increase to otherwise permitted levels ("downward-ratchet" rule).	With regard to the downward-ratchet rule, provide that the foundation is not required to decrease its holdings on account of a change in the foundation/disqualified person percentage holdings which is attributable to stock issuances or redemptions (or issuances coupled with redemptions) under certain circumstances.
	d. Aggregation rule	Amendment to Phase One: Provide that foundations eligible for the 20-year Phase One period include cases where 1969 ownership by the foundation and disqualified persons exceeded 95%.

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XII. Definition of Disqualified Person and Substantial Contributor (sec. 507(d)(2))	A substantial contributor is defined as any person who contributes during a year more than $5,000 if such person's contributions exceed more than 2% of all contributions received by the foundation before the end of that year. A donor who meets that definition retains status as a substantial contributor regardless of the relationship between the amount of the donor's contributions and all contributions subsequently received by the foundation measured, e.g., 15 years later.	Provide that a person may lose status as a substantial contributor for certain purposes.

Additional Item	Present Law	Treasury/Staff Suggestion
Mandatory Payout	In ERTA, section 4942 was amended to define the required minimum payout as five percent of the value of the foundation's net investment assets (rather than the higher of that figure or net income). The amendment did not add back to the newly defined payout amount the previously applicable modifications set forth in Code section 4942(f)(2)(C), relating to (i) repayments to the foundation of amounts previously treated as qualifying distributions (e.g., scholarship loans); (ii) amounts received on disposition of assets previously treated as qualifying distributions; and (iii) amounts previously set aside for a charitable project but not so used.	Add to the required minimum payout the amounts specified in Code section 4942(f)(2)(C) (certain loan repayments, proceeds from asset dispositions, and unused set-asides).